OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

FAIR USE POLICY

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

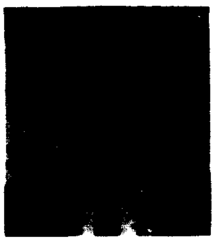
D01709

Capital Is Not Enough

THIS SERIES of articles on the aims and work of development banks, sometimes known as agencies or corporations, in developing countries, continues with a profile of the Development Finance Corporation of Ceylon.

Development Finance Corporation of Ceylon

By L. A. Weerasinghe



***The Author:** L. A. Weerasinghe has just retired from being the General Manager of the Development Finance Corporation of Ceylon for the last six years. He is a Fellow of the Institute of Chartered Accountants of England and Wales and has been the President of the Institute of Chartered Accountants of Ceylon for several years. He is a Regent of the University of Ceylon, a Member of the Governing Board of the Ceylon Institute of Scientific and Industrial Research (CISIR) and a Member of the Panel of Conciliators maintained by the International Centre for Settlement of Investment Disputes, Washington, D. C., USA.*

The Development Finance Corporation of Ceylon (DFCC) was established in 1956. It was the third of three new organs which the International Bank for Reconstruction and Development (IBRD) Mission to Ceylon considered necessary for the proper planning and execution of the economic development of the country.

According to the report of the Mission, the first new body to be formed was the Economic Committee of the Cabinet, aided by an Economic Planning Secretariat, whose task was to plan development as a whole, to supervise the necessary surveys and to co-ordinate requests for external aid. The second body was the Ceylon Institute of Scientific and Industrial Research (CISIR), which was to be an organ for technical research and inquiry, and finally the DFCC, which was to be the executive financial arm to promote and carry out specific production projects in partnership with private interests.

The Economic Planning Secretariat, after a chequered existence, was replaced by a Ministry of Planning and Economic Affairs, set up in 1966. This Ministry, which is under the Prime Minister, is making rapid headway in the planning and supervision of the economic development of the country.

The CISIR, which has recently been brought under the Ministry of Housing and Scientific Research, is being reorganized to enable it to function more effectively.

The DFCC is expanding its financial activities in the private sector owing to the improvement in the climate of investment prevailing at present. Its ability to obtain foreign-exchange lines of credit augurs well for the future.

Incorporation

Incorporating the DFCC by a special Act of Parliament has made it possible for the Corporation to enjoy privileges not available to companies incorporated under Company Law. These privileges were considered necessary for the successful operation in Ceylon of a development bank, the share capital of which was to be privately held and the management undertaken by a Board of Directors, the majority of whom were to be elected by the shareholders. The privileges include interest-free long-term loans from

A DFCC-financed project: biscuits from the Maliban Biscuit Manufactories Limited being shipped to overseas markets

the Government, the furnishing of guarantees by the Government and tax-exemption in respect of borrowings by the DFCC from international and foreign organisations approved by the Government. As a result there is a measure of Government control in the affairs of the DFCC. As long as long-term borrowings from the Government are outstanding, the Government is entitled to nominate a Director to the Board, which is also required to set aside annually a special reserve of not less than 20 per cent of its net profits until the reserve equals the amount of the loan outstanding. It is also prohibited from declaring dividends in excess of 12 per cent of its share capital.

In addition, the DFCC must, while Government loans and guarantees are outstanding, submit its annual reports to the Minister of Finance for presentation to Parliament. The benefits accruing from the privileges granted to the Corporation have far outweighed any limitation of autonomy caused by a measure of Government control. In the final analysis, the direction of the business of the DFCC rests with its own management.

Functions

The specific purposes for which the DFCC was set up were to assist in the establishment, expansion and modernization of private industrial, agricultural and commercial enterprises in Ceylon and to attract domestic and foreign private capital. Private industrial and commercial enterprises are defined in the DFCC Act as undertakings in which the Government holds not more than 20 per cent, and agricultural enterprises as large agricultural or livestock companies operated on a commercial basis. Commercial enterprises eligible for financing by the DFCC include projects that are conducive to economic development such as hotels, transport, construction and engineering, but exclude undertakings solely engaged in buying and selling.

The tasks of the DFCC include:

- The granting of loans of from five to fifteen years to limited liability companies incorporated under the Company Law of Ceylon and/or subscribing to shares (Ordinary or Preference) in such undertakings;
- The underwriting of new issues of shares and other securities;
- The guaranteeing of loans;
- Advising on managerial and administrative matters and/or assisting in obtaining managerial, technical and administrative services for private industrial, commercial and agricultural enterprises in Ceylon;
- Using its local connexions to introduce foreign investors to suitable Ceylonese partners for the establishment of joint ventures;
- Assisting clients in the formulation of their projects and advising on the appointment of technical experts; and
- Taking a continuous interest in the welfare of its clients and considering the finance for extensions of, and improvements to, their existing businesses.

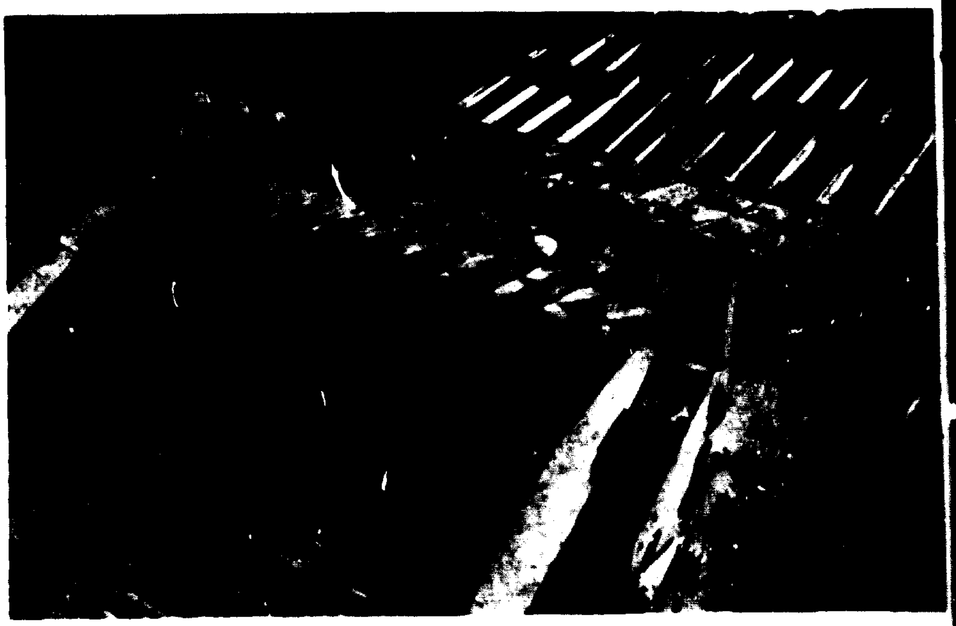
Funds

The funds available to the DFCC come from its own capital, a loan from the Government, borrowings from other sources, repayments of its own investments and reserves generated by it.

Of the authorized share capital of Rs 24 million (US $1.0 = Rs 5.95), Rs 8 million has been issued and fully subscribed. At present 25 per cent of the share capital is held by government-owned institutions, 38.4 per cent by private individuals and institutions and 36.6 per cent by foreign shareholders, mainly British banks and the Commonwealth Development Finance Company Limited of the United Kingdom. The shares are quoted on the local stock exchange and are freely transferable.

The current loan from the Government is for Rs 16 million, interest free and repayable in fifteen annual instalments beginning in 1981. In the event of liquidation, this loan is subordinate to the share capital and other debts of the DFCC. Borrowings available from other sources consist of overdrafts and loans from local commercial banks, refinancing from the Central Bank of Ceylon and credit from the IBRD and other foreign lending institutions.

The overdraft and loan facilities utilized thus far have been confined to the Bank of Ceylon, on pledge of equity investments made by the DFCC. The refinancing scheme with the Central Bank permits loans for further financing to be granted by the DFCC on mortgages of land, buildings, furnishings and equipment that is to be replaced. Other funds available locally for the activities of the DFCC are the repayment of its investments and reserves. The yield from this source might have been considerably higher but for the high rate of income tax, which absorbs about 50 per cent of its profit.



Baked biscuits streaming out on stacker through automatic metal detector

Foreign funds available to the DFCC are from an IBRD dollar credit guaranteed by the Government of Ceylon and repayable over a period of fifteen years. Further credits are expected to be obtained shortly from the IBRD and a German development bank.

Management

The DFCC is managed by a Board and nine directors. Six of them, from which the Chairman of the Board must be elected, are elected by the shareholders. The DFCC has been fortunate in having among the directors elected by the shareholders leading bankers, businessmen, industrialists and lawyers, and its healthy position is in a large measure attributable to their caution and independence.

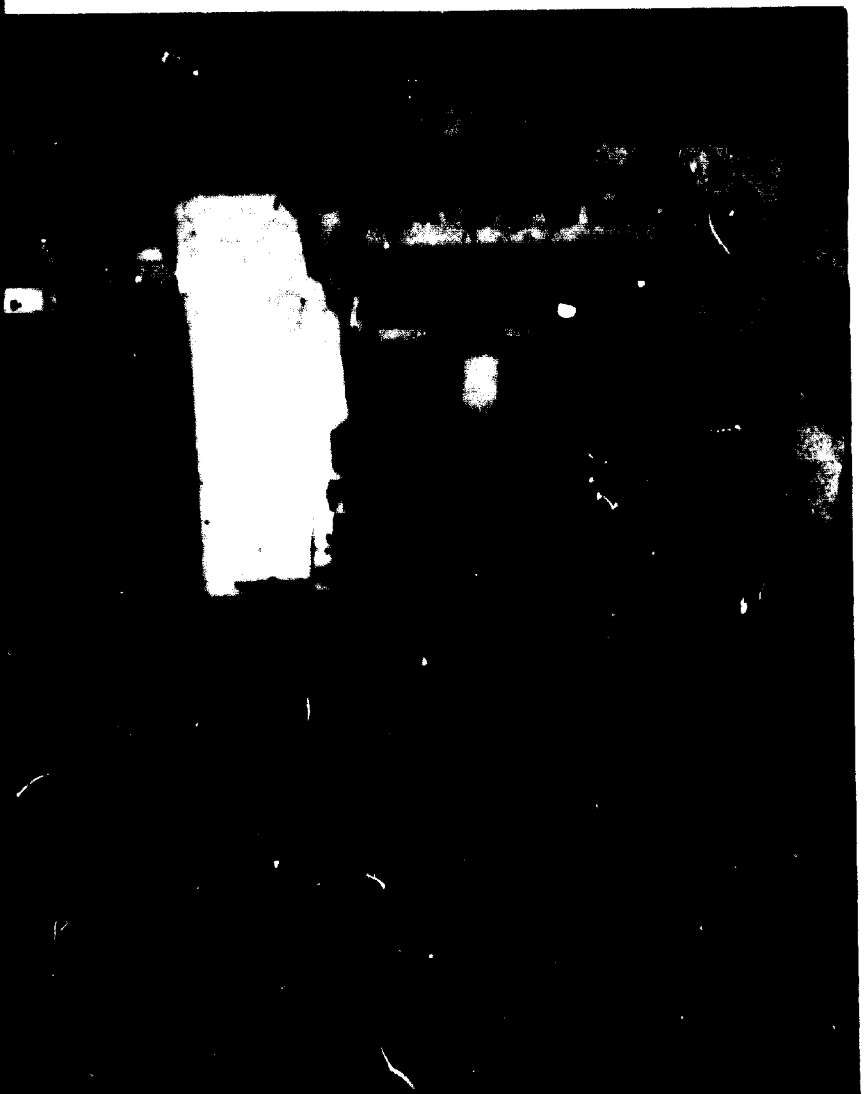
Of the remaining three Directors, one is a government nominee and two are *ex-officio* appointments held by the Director of the CISIR and by the General Manager of the DFCC. As noted above, the Director nominated by the Government holds office as long as there is a government loan outstanding. The Director of the CISIR was given a place on the Board according to the Act incorporating the DFCC, so that projects, including assistance, could have the benefit of technical and engineering advice. However, owing to a shortage of qualified staff in the CISIR, the technical expertise expected has failed to materialize, and the DFCC has, therefore, been obliged to begin building up an engineering section of its own.

A policy statement agreed to between the Board of the DFCC and the IBRD sets out guidelines for conducting the day-to-day business of the DFCC. This is entrusted to a General Manager, assisted by an adviser appointed by the IBRD and a small staff, including a few officers who have received training in development banking at the IBRD and other development banks.

Operational activities

Certain basic industries which, it is felt, private enterprise has neither the resources nor the expertise to develop, are being established by the State. These include cement, ceramics, caustic soda, chlorine, fertilizer, mineral sands, paper, petroleum, plywood, steel and automobile tires and tubes. The Government, however, has stated that it is prepared to consider proposals for private participation in these industries, in conjunction with foreign expertise and capital, if necessary, provided the arrangements are advantageous from the national point of view. The project must be approved by the Ministry of Industries and, under the priorities in operation, special consideration is given to: industries likely to stimulate agricultural development; industries based primarily on indigenous raw material; industries with export potential, such as cotton and synthetic textiles, building and construction materials; light engineering; and industries that produce import-substituting consumer goods.

Automatic biscuit wrapping machine with reels of labels in foreground



The DFCC comes into the picture after a project has been approved by the Ministry and its sponsors seek assistance. There is no standard method of applying to the DFCC for assistance. At the first stage a brief written summary of the project and the finance involved is helpful. If it appears that the project might be suitable for financing by the DFCC, a feasibility study is undertaken to discover whether the project is commercially viable. The DFCC relies on the ability of the assisted enterprises to make adequate profits. Thorough studies are undertaken to ensure that the project evaluations carried out by the DFCC staff are adequate.

In practice, the DFCC limits its financial assistance to the amount that has been put into an enterprise by its owners. This acts as a brake on speculative practices and generally ensures greater responsibility on the part of the owners. The rate of interest is fixed at the time a loan is made and continues for the duration of the loan. At present, the rate is 7 per cent *per annum* for rupee loans and $9\frac{1}{2}$ per cent *per annum* for foreign-currency loans. As a rule, loans are not granted for amounts above 60 per cent of the value of the plant and machinery and 75 per cent of the land and buildings. The terms of repayment may vary from five to fifteen years, with a reasonable period of grace to allow for construction and the setting up of the project. In the case of equity investments, provisions are made in the Memorandum and Articles of the company borrowing the finance to safeguard the investment. Where the investment is large, the right to a seat on the Board of Directors of the company concerned is generally a condition of the loan. In practice, it is found that the most effective way to protect an equity investment is to develop the enterprise that has been assisted. The DFCC endeavours to do this by rendering as much assistance as possible in terms of finance and expertise.

During the twelve years of its existence the DFCC has invested Rs 76 million in 85 projects and helped to bring to completion investments of over twice that amount. These investments are spread over various types of enterprises, including chemical, rubber, metal and electrical products, building materials, textiles, engineering, printing and packaging, food and beverages, and agriculture. Dividends to shareholders have steadily increased from 3 per cent in 1960 to 8 per cent in 1967 and 1968, and the price of a Rs 100 share is quoted on the local stock exchange at Rs 115.

PRIOR TO INDEPENDENCE, the economy of Pakistan was preponderantly agricultural. The figures for 1969/1970 show that the contribution of the manufacturing sector to the gross national product (GNP) was 7 per cent from small industries and only 1.5 per cent from large ones. In absolute terms, however, the contribution of industry to the GNP in 1959/1960 was 2,930 million Pakistani rupees (US $1.00 = 4.761 Pakistani rupees) and 6,245 million (at current factor cost) in 1967/1968. It is currently 10 per cent of the GNP.

Much of this growth in the industrial sector has occurred in what may be called the empirical industrial sub-sector such as textiles. There are considerable possibilities for innovation in this area, but not as many for the introduction of revolutionary technological processes. Furthermore, the textile industry has been concerned primarily with production methods for which it has had to rely on foreign expertise. As a result, important sub-sectors of the industry, such as dyes and the machinery for textiles, have been neglected. The annual production

In Pakistan, the first research organization was the Central Cotton Committee, established in 1948. This was followed by the Central Jute Committee in January 1951, the Pakistan Medical Research Council and the Pakistan Council of Scientific and Industrial Research (PCSIR) in 1953 and the Pakistan Atomic Energy Commission (1956). Following the recommendations of the Scientific Commission in 1960, three more Research Councils, besides those of the Atomic Energy and Scientific and Industrial Research, were formed or reorganized:

- The Agricultural Research Council of Pakistan (ARCP);
- The Council for Works and Housing Research (CWHR);
- The Council for Irrigation, Drainage and Flood Control.

With the possible exception of the PCSIR, the Councils are closely associated with the service sector, so a proper balance among the three primary

10. 6. 71